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EAST EUROPEAN MODELS FOR CHINESE ECONOMIC REFORM

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Author: Donald R. DeGlopper

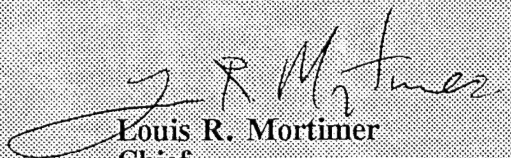
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PREFACE

This report addresses Chinese interest in East European economic reforms. It is intended to aid understanding of possible directions of Chinese economic reform. It considers China's economy as an example of a Soviet-style, centrally planned economy, and argues that Chinese planners and policymakers find the experience of their East European counterparts more relevant to their situation than that of Western economists and managers. Since China plans to fund military modernization from the economic growth expected to be generated by economic reform, the success of reform will directly affect the pace and form of military modernization.

This report is based on review and analysis of Chinese, US, West European, and Japanese press, journals and monographs. Information is current as of 1 June 1984.

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SUMMARY

China's current leaders plan to achieve modernization, including military modernization, through reform of their economy. China has a centrally planned economy marked by widespread inefficiency, waste, and mismanagement of scarce resources. The goal of Chinese economic reforms is a more efficient and sophisticated centrally planned and directed economy.

In 1983 China became increasingly interested in the economic reforms pursued, since the mid-1960s, by various East European countries with Soviet-style economies. The relatively successful Hungarian model has been of special interest to the Chinese. Chinese press reports have treated Hungary as a model from which much could be learned and have implied that reform of a Soviet-style economy is possible.

In contrast to Chinese optimism concerning East European economic policies as models, Western specialists draw attention to the extreme difficulty in implementing reforms. Although Chinese reforms are likely to face similar opposition and delay, with the benefit of East European lessons, the leadership should be able to anticipate major obstacles. While the outlook for rapid economic growth based on quick implementation of major reforms is not optimistic, piecemeal measures yielding incremental improvements in economic performance and permitting military modernization to proceed at an accelerated pace do seem likely.

EAST EUROPEAN MODELS FOR CHINESE ECONOMIC REFORMS

1. INTRODUCTION

Since Deng Xiaoping's consolidation of power in 1978, China's leadership has admitted to shortcomings in the country's economic performance and has called for major reforms in economic organization. Economic growth and modernization are now the primary goals, a policy direction summed up by the slogan "Promote the Four Modernizations" (industry, agriculture, science and technology, and national defense).

Military modernization has the lowest priority in the development program. Official statements have made clear that military modernization is to be financed from expected rapid economic growth following the anticipated successful implementation of major economic reforms. These reforms, therefore, are a critical forerunner of any significant advances in military development. Since the Chinese leadership has determined that civilian sectors have priority over the military, the results of the Chinese search for solutions to their economic problems directly affect both the rate and extent of defense improvements.

The starting point for economic reform is dissatisfaction with the performance of China's Soviet-style economic system. The hallmarks of a Soviet-style economy are central planning and administrative allocation, high rates of savings and investments, concentration of resources on heavy industry at the expense of agriculture and consumer goods, collectivization of agriculture, and state ownership of industry. Such systems emphasize high production of a few key defense-oriented products and fulfillment of planned production quotas on schedule as the primary goal of managers. The drawbacks are a high degree of enterprise self-sufficiency, overinvestment in some sectors, low productivity, unbalanced growth, a high degree of waste and duplication, and a general absence of incentives for innovation. Although this system generally provides initial high rates of economic growth, these advances tend to be shortlived as the negative factors become more significant.

Since 1980 published Chinese statistics and scores of accounts in the official press have documented domestic problems of waste, inefficiency, failure to innovate, and low levels of productivity. As a result, the leadership has agreed that major economic reforms are necessary to overcome or at least alleviate these constraints to modernization. Since 1981 the Chinese have made major changes in agricultural policy, of which the most important have been increases in prices paid farmers for crops and the replacement of the collectivized commune system with various sorts of "responsibility systems" in which households contract to work fields and perform processing and transport tasks, profiting directly from their efforts and skill. The shape reform in the industrial sectors is to take has been less clear. The trend is toward a decentralized system which gives greater decisionmaking power to enterprise managers rather than central administrators, and makes profitability rather than quantity of production the key measure of performance. Enterprise management is to be increasingly separated from state administration, and enterprise efficiency is to be encouraged by such indirect and flexible levers as tax rates, bank credit, and greater degrees of competition and consumer choice. Deciding exactly what steps to take to do this is, however, a difficult task. It is here that the role of East European models for economic reform is most significant.

2. CHINESE INTEREST IN EAST EUROPEAN ECONOMIC REFORMS

The Chinese have taken a renewed interest in the outside world since the end of the Cultural Revolution (1966-76). China is now more receptive to the non-Communist world than at any time since the foundation of the People's Republic in 1949, but there are still definite limits to Chinese willingness to adopt foreign practices. Statements in the Chinese press indicate the desire to learn management techniques from capitalist economies, or to study the experiences of such successful economies as those of Japan, South Korea, Taiwan, or Singapore. Press statements also make it clear that the basic Socialist features of China's economic system will not be changed. For example, a 16 November 1983 Renmin Ribao [People's Daily] reprint of an article from a Beijing University journal made the point that:

We should not neglect the fact that the modernization we are striving to build is based on a socialist society rather than on a capitalist society . . . some basic premises on which (western) economics is based are in conflict with the socialist system . . . modern bourgeois economics cannot be taken as a guideline for developing our national economy.

The goal is not to abandon altogether the Soviet-style economic system, but to adapt it to utilize Chinese resources better; hence, the Chinese interest in those aspects of the East European economic experience that are applicable to China.

While the Soviet Union has reformed some aspects of its own economy and continues to discuss reforms, most East European countries have moved further away from the classic Soviet or command economy model. In general, their reforms have included attempts at decentralization, price reform, an increased role for market forces, increased returns to agriculture, and increased participation in the world economy. Yugoslavia, with its workers' councils controlling factories and its "market socialism," has moved furthest from the Soviet model, but it has suffered high rates of inflation and unemployment. Hungary is generally regarded as having been most successful at reform. It has expanded the private sector and the role of market forces, but retained a degree of central planning and direction. Although in the late 1970s the Chinese expressed interest in the Yugoslav experiment, and especially in the workers' councils, more recent attention has focused on Hungary.

For the Chinese, the economic reforms in Eastern Europe offer case studies of the consequences of changes in several systems somewhat comparable to their own. They provide concrete examples of ways to translate general goals into specific administrative measures. There are, however, limits to the comparability of the East European economies, and these make it difficult if not impossible to directly transfer such practices to China. East European countries, for example, are smaller than most Chinese provinces, and almost all of these countries suffer from severe labor shortages. Other characteristics of East European nations that differ from China include: foreign trade making up a large proportion of their economic turnover, and subsequent important questions of currency rates and convertibility; and, they are practically all dependent on imported oil or energy and have suffered severely from the rise in world oil prices since 1973. Since some of the East European reforms were motivated by and designed to address such problems, these would not be of immediate concern to China.

3. EXCHANGE OF ECONOMIC DELEGATIONS BETWEEN CHINA AND EASTERN EUROPE IN 1983

In 1983 there was increased evidence of Chinese interest in East European economies. A November 1983 Xinhua account identified the Chinese Academy of Social Sciences' Eastern Europe Research Institute. Furthermore, a series of delegations of economists and central bankers from China and Eastern Europe exchanged visits during 1983. The most important of these were:

- ° May: A delegation from the People's Bank of China visited Hungary to study its economic administration and the role the Bank of Hungary plays in the country's economic life.
- ° June: An economists' delegation led by the deputy general secretary, Economic Research Center of the Economic Reform Commission of China's State Council, visited Hungary for several weeks to study economic reforms.
- ° September: A Chinese delegation led by a vice minister of Finance completed a 3-week visit to Hungary, where they made a study of Hungary's financial system.
- ° October: Chinese Vice Premier Wan Li received the visiting Hungarian minister of Foreign Trade, the highest Hungarian Government official to visit China in 20 years. Wan said that China would like to exchange experience with Hungary which has had great success in reforming its economic system.
- ° November: Chinese Vice Premier Tian Jiyun received a delegation from the National Bank of Hungary, and spoke highly of Hungary's economic reforms, saying, "We shall earnestly study your experience." Also in November, a delegation of Hungarian economists visited China at the invitation of the Chinese Academy of Social Sciences. After meeting Vice Premier Wan Li in Beijing, the delegation leader, a principal reform advocate, praised China's streamlining of its economic structure and advised pushing ahead in spite of obstructions and difficulties. Later in the month, a Chinese economic study group, headed by the vice director of the Eastern Europe Research Institute, spent 3 weeks in Czechoslovakia, the first such visit there in 20 years.

The visits, in many cases the first such exchanges in several decades, were of a length and composition that indicate serious interest. The Chinese delegations were composed of professional economists, bankers, and planners who were able to discuss matters of mutual concern with their foreign counterparts. The series of visits provide concrete evidence of high-level Chinese interest in East European economic policies. The dissemination of some of the information gathered in Eastern Europe by the Chinese press is a further indication of official interest in the topic.

4. EASTERN EUROPE IN THE CHINESE MEDIA

Throughout 1983 and early 1984 major Chinese newspapers such as Renmin Ribao and Jingji Ribao [Economics Daily] carried many lengthy, detailed accounts of East European economic reforms. Topics included Romanian methods of training cadres who manage state enterprises, Bulgarian use of contracts within the planned economy, Yugoslav attempts to solve foreign debt problems, and Hungarian devolution of decisionmaking power to enterprises. Chinese economic journals

also carried general articles on East European and Soviet economic problems, as well as comparative studies of such matters as wage policies and central-local relations in those countries.

While Western accounts of East European economic reforms have stressed price reform as a precondition for increased use of market forces and increased integration with the world economy, Chinese accounts have focused on different issues. For them, increased enterprise autonomy and decisionmaking powers for managers, an enhanced role for the taxation and banking systems, and an increased, but still circumscribed, role for market forces and small-scale private enterprise are the major topics. For example, an April 1983 Renmin Ribao account of the decisionmaking power of enterprises and of decontrolled prices in Hungary states:

Following the implementation of a new economic system in Hungary, state-owned enterprises will no longer turn over profits but pay taxes to the state.

It explains how the state is able to limit and control the decisions of enterprise managers through changes in tax rates and through the State bank's discretion in granting loans for investments.

Another example was a lengthy account of a visit to a private produce shop in Budapest. The report, published in a June 1983 issue of Liaowang [Observation Post], explained the advantages of long-term preservation of a variety of ownership systems, including individual business operations. Also, a November 1983 interview with Hungarian economist Niersh Leire in the Beijing Jingji Ribao quoted him as saying that the most important lesson of Hungary's 15-year experience of economic reform is that Socialist operations can be conducted very flexibly and efficiently and can compete with capitalist operations. The re-emergence of small, privately owned and operated shops and other businesses throughout China is an indication that Beijing is now promoting the usefulness of different types of economic systems including limited capitalism. The Chinese, however, would not use the term "capitalism" to define their current system.

5. LESSONS FROM EASTERN EUROPE

The Chinese clearly emphasize those aspects of the East European experience that are most congruent with China's own attempts at reform. In published accounts various East European countries and especially Hungary are presented as models for study and emulation, much like domestic exemplars such as the Daqing oil field or the Capital Iron and Steel Company. The presentations range from generally upbeat to totally adulatory and are made regardless of the validity of the claims. The message for the Chinese reader is clear and includes the following major aspects:

- ° effective reforms to Soviet-style economies are possible;
- ° reforms produce prosperity and economic growth;
- ° reforms are not a reintroduction of capitalism; central planning and state control of the economy are retained;

- o potential problems, such as the "anarchy" that may result if enterprise managers maximize their own profits at the expense of the larger whole, have been foreseen and avoided as much as possible;
- o reforms represent a more advanced, sophisticated form of Socialist economy; and
- o experts have a clear idea of the necessary steps and are working at applying the appropriate lessons from Eastern Europe to the Chinese situation.

The implicit political lesson is that loss of faith in the Chinese Communist Party and the current leadership is unjustified. What works in Hungary and other East European countries--small countries with few resources--will work in China, a large country with many resources, and perhaps work even better.

6. WESTERN APPRAISALS OF EASTERN EUROPE'S REFORMS

Western observers do not believe Eastern Europe's economic reforms are an unqualified success. They draw attention to the partial, incomplete nature of the reforms, to the bitter internal opposition which has often caused reforms to be rolled back or severely modified, and to the generally unimpressive economic results which have been achieved. Many question the benefits that can be expected from tinkering with the margins of what they consider an inherently irrational and inefficient system. All agree that partial reforms limited to either one aspect, such as taxation or agricultural policy, or to one experimental enterprise or region are not likely to accomplish much and, by disrupting the system, may make matters worse. The consensus is that to be successful reforms must be comprehensive. Successful reforms include the price system, wage and employment policies, taxation, banking, and financial and foreign exchange systems, and so forth. In general, comprehensive reforms in Eastern Europe and the Soviet Union have proved very difficult to put into practice because of opposition from powerful vested interests ranging from central bureaucrats and Party cadres lacking professional skills to regional authorities running inefficient factories with no competition.

7. CHINA'S ECONOMIC POLICY FORMATION

Although Chinese economists are quite interested in East European reforms, and the Chinese press has presented those reforms in very positive terms, neither has publicly advocated direct adoption of any specific practice or reform. Articles on such topics as Hungary's successes or the Soviet Union's persisting economic problems serve rhetorical as much as informative purposes. Given the nationalism common to Chinese leaders and individuals writing for public consumption, advocacy of direct adoption of any foreign practice, even the much-praised Hungarian taxation system, will not be encountered.

Chinese specialists on East European economic reforms are professional economists associated with various "think tanks" such as Academy of Social Sciences Institutes. They contribute to economic policy formulation through the advice and consultation they provide to the State Council and important political leaders. Economic policy in China is formulated in a complex political process involving central economic ministries, provincial authorities, Communist Party organs, and others. Policy set forth by the central leadership in Beijing is

modified by regional and local leaders attempting, with varying degrees of enthusiasm and commitment, to put it into practice. Specific reforms such as a proposed tax system modeled very closely on the Hungarian model can contribute to the Chinese system, but they cannot be expected to be precisely duplicated.

Although other external and internal factors, in addition to the East European reform experience, clearly influence Chinese economic leaders, it is evident that Beijing is trying to learn to minimize its own mistakes as much as possible. These pragmatic officials are aware that their present system has numerous bottlenecks and other weaknesses that hamper modernization. China's experience, people, and resources, must be considered in designing reform.

8. CONCLUSIONS

While it is difficult to determine the extent to which present and proposed Chinese economic policies are directly modeled on East European reforms, China's economic policymakers are taking the East European experiences into account. Either because of direct transfer or because of comparable problems arising in comparable economic systems, most of the proposed Chinese reforms are similar to those attempted in the Soviet Union and Eastern Europe. The many revisions to and partial reversals of reforms attest to the political difficulties of implementing them. Chinese reforms may face similar opposition, but, with the benefit of lessons from Eastern Europe, Chinese leaders should be able to anticipate major obstacles to implementation. The most likely outcome is piecemeal, incremental reform, yielding incremental improvements in economic performance. Economic reform in China, as in Eastern Europe, may extend over a decade or more. With moderate economic growth, which may accelerate as the effects of reform are felt, military modernization may proceed at a measured pace.

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